Electric Choice in Michigan

WHY THE SCARE STORIES ABOUT HB5184 ARE FALSE

Presentation to: Michigan House Energy & Technology Committee on behalf of Energy Choice Now

Jonathan A. Lesser, PhD

March 25, 2014

CONTINENTAL ECONOMICS

The "scare stories" you have heard

- Choice opponents would have you believe that retail electric choice for all Michiganders will make the Biblical plagues look like a walk in the park
  - The Light Will Go Out and Jobs Will Be Lost: electric choice will reduce reliability. Competitive firms will go bankrupt and no new generation investment will be made in Michigan
  - Outsiders Will Control Michigan's Electric Industry: Michigan will be subject to federal rules that will take away state sovereignty (and contribute to the lights going out)
  - Electric Rates Will Be More Volatile: events like the "Polar Vortex" result in higher electric prices charged by competitive electric providers that would not be charged by vertically-integrated utilities
  - Restructured Utilities And Competitive Generating Firms Are Bad Corporate Citizens: retail choice means utilities and other industry participants will no longer perform "good deeds"

The lights will not go out

- Michigan is part of the Midwest ISO (MISO), which is responsible for ensuring reliable electric service in the state
  - Michigan utilities and competitive generation suppliers must comply with MISO requirements for generation reserves
  - MISO also ensures new high-voltage transmission infrastructure is built in a timely manner to ensure system reliability and enhance its competitive wholesale market
    - The costs of those transmission investments are shared by all MISO members based on their load
    - A number of new transmission projects in Michigan will be built
- These same standards apply in PJM, and many PJM states have fully competitive retail markets

Blackouts did not take place in Texas, as alleged

- Choice opponents claimed there have been rolling blackouts in Texas because of retail choice
  - False!
  - ERCOT (the grid operator in Texas) announced "emergency alerts" in August 2013 and January 2014, asking consumers to conserve power when electricity demand soared, not because there had been no new generation investment
    - No blackouts occurred
    - January alert cancelled after two hours
    - Unlike MISO and PJM, ERCOT does not have mandatory reserve requirements
  - MISO and PJM issue the same types of alerts when demand is extremely high
    - This has nothing to do with retail choice

CONTINENTAL ECONOMICS

Bankruptcy does not mean generating plants disappear

- When competitive firms make bad decisions, their shareholders bear the costs
  - When regulated utilities make bad decisions, their ratepayers often bear the costs
  - Southern Company is building a coal plant with carbon capture. The plant is billions of dollars over budget. Ratepayers will pay the bill.
- Wall Street likes regulated markets because ratepayers bear financial risks, not shareholders
  - This is why Wall Street has poured money into subsidized renewable generation: taxpayers bear the financial risk
  - Investing in projects that are subsidized by taxpayers and sell a product (renewable generation) that ratepayers are forced to buy is a nice business to be in – even if it is bad for everyone else

Bankruptcy does not mean plant shutdowns and loss of generation (and jobs)

- Yes, competitive firms (and cities) can go bankrupt
  - TXU owners bet that natural gas prices would continue to rise. They bet wrong and lost. Had TXU been a regulated utility and made the same bet, ratepayers would have borne the risk, not shareholders
- Kelson Energy specializes in buying "distressed" generating plants. It improves operations and then sells the plants to new buyers, who then continue to operate them.
  - Like repairing a "fixer-upper" home
- At last week's hearing, Consumers Energy announced it may shut down generating plants that are no longer cost-effective
  - Should those plants be forced to continue operating and ratepayers forced to foot the bill?

Exelon's announcement about its Illinois nuclear plants has <u>nothing</u> to do with retail competition

- Choice opponents point to Exelon's announcements about its nuclear plants in Illinois as an example of the failure of retail choice
- Plants in Illinois are under economic pressure because of subsidized wind generation
  - Illinois has 3,800 MW of wind generation, much of it subsidized through production tax credit
  - Illinois renewable generation mandate forces consumers to purchase wind generation
  - These two factors have "artificially suppressed" wholesale market prices, causing prices to be negative for Exelon plants hundreds of hours per year
    - Yet, subsidies/RPS mandate allow wind plants to profit even when prices are negative

New generation investment takes place in states with retail choice

- Investment takes place when markets signal a need; not when a vertically integrated utility decides it wants to increase its return
- Choice opponents point to Maryland and New Jersey as examples of states where no investment was made
  - Those states sought to undermine the PJM competitive market by subsidizing generation (paid for by ratepayers) and using that generation to artificially suppress wholesale prices
  - When state policy is designed to undermine competitive markets, unsubsidized competitors won't invest. Why would they?
    - The developers of those subsidized plants (CPV Maryland, Hess) are going ahead anyway, even though the subsidies were ruled unconstitutional by the federal courts. So why were ratepayers put on the hook in the first place?

The Indiana-Michigan power experience is <u>not</u> an example of retail competition failing

- Choice opponents point to choice customers returning to IMP as a failure of retail choice
- Situation was caused by a unique aspect of PJM – an ability to self-supply capacity reserves, called a "Fixed Resource Requirement" obligation
  - Only AEP companies and Duke Energy Ohio have this
  - Means that retail generation providers must purchase capacity from IMP
  - Michigan PSC set the price to IMP's cost, over $400/MW-day, four times higher than the PJM market price.
  - By charging such an above-market price for capacity, IMP could effectively <u>subsidize</u> energy
  - Forced all retail competitors out of the market

Retail choice does not mean fewer jobs

- If Michigan utilities spin-off generating plants into unregulated affiliates, neither the plants nor the jobs vanish
  - Economic incentive to improve those plants' operating efficiency
- Lower electric prices made possible by competition lead to more jobs in the economy
  - See J. Lesser, "Retail Electric Competition: Growing Michigan's Garden," Report prepared for Electric Choice Now, August 2012
- If an inefficient plant is shut down, jobs can be lost
  - But the cost of subsidizing jobs is always greater than the benefit!

There is no economic free lunch.

It is impossible to subsidize one's way to a growing economy.

Jobs created by lower electric prices will dwarf any potential jobs lost from plant shutdowns

- Last week, the utilities claimed 800 generating plant jobs could be lost if retail choice is enacted
  - This is a scare story. It is simply impossible that ALL generation jobs will suddenly vanish with full retail choice
- Suppose those 800 jobs did vanish. That job loss is dwarfed by the potential benefits of lower electric prices
  - My analysis has shown that a $100 million reduction in electric costs paid by consumers creates between 700 – 1,200 new jobs in the state
  - According to US EIA data, in 2013 Michiganders paid $3.5 billion over the market price (measured in Illinois)
  - That translates into between 24,500 and 42,000 jobs
  - Even if I overestimated job creation by a factor of 2, the job gains dwarf the claimed job losses

Retail choice does not mean nefarious control of Michigan's electric industry by outsiders

- MISO/PJM are overseen by FERC
- MISO/PJM operate electric markets, which have independent market monitors to ensure there is no market manipulation
- All US states are subject to interstate commerce laws
  - None of this is new
- Retail choice does not mean Michigan has no control over its electric industry
  - Michigan PUC still oversees utility local distribution and ensures distribution systems are reliable
  - Michigan PUC ensures retail electric suppliers comply with all state laws and do not mislead consumers
  - Michigan legislature decides on renewable energy mandates

Continental Economics

The January "Polar Vortex" did not prove that retail choice was bad because of volatile prices

- Polar Vortex caused natural gas demand to soar for electric generation and for heating
  - In New England, gas prices soared, reflecting high demand and limited pipeline capacity
  - Demand for electricity also soared, causing prices to rise
  - That is how markets are supposed to work – sending price signals to consumers to conserve energy
- Vertically integrated utilities recover the higher gas costs through fuel adjustment clauses, energy balancing accounts, and so forth
  - Instead of sending price signals to consumers to conserve energy, they just bill consumers later for all of the additional costs incurred

Competitive firms are not bad corporate citizens

- Consumers Energy witness implied that competitive firms are bad corporate citizens
  - Southwest Airlines, which operates in a very competitive industry, prides itself on its corporate citizenship
  - So do other competitive firms. Are GM, Ford “bad” corporate citizens?
  - Are businesses who have testified before this committee in favor of retail electric choice “bad” corporate citizens?
  - Are members of this committee who are business owners “bad” corporate citizens?
- Perhaps the witness was threatening that Michigan utilities will become “bad” corporate citizens if full retail choice is allowed
  - If so, that says a lot about those utilities, not about competition

In summary …

- Retail choice proponents have countered all of opponents' scare tactics with facts, based on empirical analysis
  - Electric prices in states with retail competition are not more volatile
  - Electric utilities in states with retail competition do not have higher credit risks
  - Retail choice is not a "zero-sum" game, where "winners" gain at the expense of "losers"
  - In the Midwest, states with retail competition have seen rates fall, while in Michigan rates have soared.
  - No amount of fear-mongering can obscure that simple fact
- Today's retail electric markets work for consumers, and work well
  - No amount of fear-mongering can obscure that simple fact either